Islāmic Finance in Mauritius: Prospects and Challenges

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Abstract

The purpose of this paper is to first illustrate the development of Islāmic finance in Mauritius, an island with a minority Muslim population which has made the necessary changes in its regulatory framework for Islāmic finance and banking since 2007, and has so far seen only sporadic development in the market. The paper also discusses the opportunities and challenges for implementing Islāmic financial services in the island. While the offshore market is an ideal platform for Islāmic financial institutions (IFIs) to set up global Sharī'ah based funds and the issuance of "*ṣukūk*", the domestic market has not shown positive responses to the existing products. For any Islāmic financial institution to succeed in Mauritius, it is required to have an inclusive business strategy and value proposition which includes key offerings under the consumer banking, commercial banking, corporate investment banking and treasury. In general, why Islāmic financial services are not taking off at full speed remains the unsolved question for many in Mauritius. Further empirical researches are required to understand and deepen the awareness in the market about the emerging financial system.

Keywords: Mauritius, Islāmic Finance & Banking, Minority-Muslims Countries, Business Strategy.

IEI Classification: I0, J33

JEL Classification: E58, E65, F53, G18, G28, N27, O55

1. Introduction

Islāmic finance has been growing rapidly since its launch in the 1970s. The major market for this industry is typically the Middle East, Southeast Asia and it is gradually gaining popularity in Europe, USA, Australia and Africa. While the amount of published information concerning Islāmic banking principles and their application in Muslim countries continues to

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grow, relatively little relates to its application in countries which have small population of Muslims (Gerrard & Cunningham 1999). There is still a little coverage or related data on Non-Muslim states, although a number of Muslim minority countries have amended their regulatory framework and tax structure and gradually introduced various Sharīʻah-compliant finance products in the last couple of years (Ahmad, Kashif-ur-Rehman & Saif (2010), Khan & Bashar (2008) Mirza & Halabi (2003), Sarker (1999).

Most of the literature /reviews on Islāmic finance and banking cover the principles, prospects and challenges from a universal approach which may not be applicable for non-Muslims states. It is still debatable whether a homogenous approach to implementing Islāmic finance and banking in non-Muslim states is appropriate. Muslims face difficulty with regard to the conduct of financial affairs in non-Muslim countries (El Diwany 2010). It is also argued that the concept of Islāmic finance is inherently appealing only to Muslims to fulfil their religious obligations. However, studies have shown the contrary. Cengiz and El-Bdour (1989) concluded that in considering motives responsible for selecting Islāmic banks as depository institutions, religious motives did not stand out as being the only significant ones and that the bank customers are profit motivated. In a study of customer satisfaction and preferences in Jordan, Kamal, Ahmed & Khalid (1999) claimed that customers expressed their dissatisfaction with some of the Islāmic banks services. Another study found that alongside religion being a factor for choosing Islāmic banking, there are other factors which are significant to the customers when selecting a service provider (Rashid, Hassan & Ahmed 2009), and Islāmic banks must offer quality services while maintaining their Islāmic credentials and reputation. In addition, they must also embrace good customer services' policies to reap its potential as a strategic tool to achieve competitive advantage, enhance reputation and secure customers allegiance (Dusuki & Abdullah 2007). Dusuki (2008) in a later study concluded that Islāmic banks must not be solely profit-driven entities; they must aim at promoting Islāmic norms and values to achieve the economic objectives as prescribed by Sharīʻah and true success for Islāmic banking participants depends on the extent to which they can integrate social goals with the mechanics of financial innovation.

What may be inferred from various studies is that there are various factors that may have a direct impact on the application of Islāmic banking services. Another conclusion that one may derive is that the acceptance of Islāmic banking services may be different in Non-Muslims countries. As a result, this paper is an attempt to illustrate the main factors and drivers to

successfully set up Islāmic financial institutions in Mauritius, a minority Muslims country. The paper also provides an overview of the Islāmic finance development over the last decade. Is Mauritius, a multi-ethnic island state with 17% Muslim population of Indian origin, in a position to reap from Islāmic financial services and join other financial centers to include Islāmic finance as part as its products & services and how complex is the local business environment to integrate Islāmic finance and banking in the domestic markets? These questions are critical factors to understand before embarking into a new banking philosophy in Mauritius.

2. Mauritius: A Brief Introduction

Mauritius, an Island located a few thousand kilometers off the east coast of South Africa is about 1,865 square km in size and runs merely 62.4 Km and 46.4 Km at its widest (Emrith 1994), and has a mixed population, about 1.2 million inhabitants consisting of 68% of Indian descent, 27% of African origin, 3% of Chinese origin and 2% of Franco-Mauritians (Cowaloosur 2014). The Arabs were the early settlers (Emrith 1994, Bhuglah, 2005); however this claim is based on the erroneous belief that the island appeared on a map by the twelfth century geographer al-Sharif al-Idris according to Toorawa (2007).

The Island, which was first explored by the Portuguese in the 16th century and subsequently settled by the Dutch – who named it in honor of Prince Maurits ban Nassau – in the 17th century (CIA-The World Fact Book 2012) had a dual colonization. The French assumed control in 1715, developing the island into an important naval base overseeing Indian Ocean trade, and establishing a plantation economy of sugarcane. The Island was later captured by the British in 1810, during the Napoleonic Wars until it attained its independence in 1968 (World Fact Book 2012).

As a result, Mauritius has a ‘hybrid’ legal system; combining both the civil and common law practices. Its legal system is governed by the principles derived both from the French Code Napoleon and the British common law. (See appendix 1 for Mauritian Laws applicable to relevant sectors). As early as 1941, provision was included in the law for what was originally called the *Muhammadan Waqf Ordinance*, later the *Waqf Act* which enables persons of the Muslim faith to bequeath property in perpetuity for charitable, pious or religious purposes (Glover 2011).

2.1 Mauritius Economy

Mauritius, being strategically located in the Indian Ocean has built a solid reputation as a premier international business hub, providing operational

security and commercial flexibility to investors over the past 2 decades. Mauritius ranks the 20th in the list of ease of doing business (Business report 2014). The island has managed to sell itself as African, Indian, Chinese, French and British simultaneously (Cowaloosur 2014). Its trading partners are basically the European Union, India, China, South Africa and the USA (see table 1). The relationship with these trading partners is dated back to the early settlers and the post colonization era. Cape of Good Hope (Cape Town) and Mauritius were known to sailors as early as 1497 (Allen 1999). The allocation of quasi-investment monopoly of different sectors to India and China can be traced back to the professional divisions of the colonization era (Cowaloosur 2014) that restricted the participation of Indian and Chinese into the separate sectors of the economy (Hugette 1985, Reddi 1999 cited in Cowaloosur 2014).

Table 1: Mauritius: Trade Partners

Total Mauritian Trade with the World (2010): 4,617.4 million Euros			
Rank	Partners	Millions Euros	%
1	EU 27	1691,5	36.6
2	India	716,6	15.5
3	China	433,2	9.4
4	South Africa	356,4	7.7
5	United States	227,1	4.9

Source: Adapted from Eurostats, March 21, 2012, *Mauritius: EU bilateral trade with the world.*

The Mauritian economy which was historically based on sugar production has moved to a far more diversified economy. It has in fact expanded into textile and clothing, tourism and more recently into financial services to fully integrate into the global economy. Mauritius has been successful in achieving rapid growth rate which can be attributed to the comprehensive adjustment programs launched by the government in early 1980s (Bundoo & Dabee 1999). Over the past two decades, real GDP growth has averaged about 4-6% per year, leading to a rise in per capita income. The GDP growth (annual %) in Mauritius was reported at 3.3% in 2012, and the “financial and insurance activities” expanded by

5.7% higher than the 5.5% growth previously estimated (Statistics Mauritius, March 2013 issue).

Table 2: GDP: Sectorial Real Growth Rates (year-on-year)

				Per cent
	2010	2011[1]	2012[1]	2013[2]
Agriculture, forestry and fishing	-0.8	+4.1	-0.2	+6.0
Manufacturing	+1.9	+0.7	+2.2	+2.1
of which: Textile	0.0	+3.0	-1.1	+2.0
Construction	+4.3	-0.2	-3.0	-7.7
Wholesale and retail trade; repair of motor vehicles and motorcycles	+4.0	+3.7	+3.9	+3.8
Transportation and storage	+3.4	+2.5	+2.1	+2.6
Accommodation and food services activities	+6.0	+3.5	+0.0	+2.5
Information and communication	+10.9	+9.0	+8.6	+8.2
Financial and insurance activities	+4.5	+5.6	+5.7	+5.5
Real estate activities	+2.7	+2.9	+2.8	+2.8
Gross Domestic Product at basic prices	+4.2	+3.6	+3.3	+3.3

[1] *Revised*, [2] *Forecast*
Source: Statistics Mauritiusvarious Issues

2.1.1 The Finance Industry

The banking sector comprised 21 banks as at end-December 2013, of which 7 are local banks, 9 are foreign owned subsidiaries, 1 is a joint venture, 4 are branches of foreign banks, while 13 of these banks are fully operative in the domestic market. All the banks are licensed by the Bank of Mauritius (BoM) to carry out banking business locally and internationally (BoM 2013). In spite of the various shocks facing the international banking landscape over the recent years, the domestic banking sector has shown satisfactory performance (Financial Stability Report 2013). Banks remained relatively strong (see Appendix-2) except for the new comers in the market.

Although the Mauritius Commercial Bank, State Bank of Mauritius and Barclays Bank Mauritius Ltd continued to be the leading banks in terms of assets and profits, significant improvement in market concentration in the banking sector has been noted. The Herfindahl-Hirschman Index (HHI) for total assets fell from 1,443 in December 2005 to 1,078 in September 2012 (MBA 2013).

As part of continuous effort to achieve a well-regulated and robust banking environment, the CAMEL rating system, as an additional supervisory tool to measure the financial strength of a bank was

introduced by the BoM in March 2011. This initiative is aimed at encouraging banks to improve their performance. The recent CAMEL rating of local banks shows that 14 banks scored satisfactory (2+ and 2-), 6 banks scored fair (3+ and 3-) and 1 bank scored marginal (4+ and 4-) out of the 5 combined components namely: capital adequacy, asset quality, management, earnings and liquidity respectively. (See Appendix 3 for the recent published CAMEL rating).

The finance industry also includes 8 Non-Bank Deposit Taking Institutions (NBDTIs) which operate along with the major banks. The activities of NBDTIs mainly comprise the mobilization of deposits and extension of leasing and loan facilities. The NBDTIs' assets grew by 13.1% over last year to Rs. 54,855 Million as at end-June 2013 (BoM 2013). The minimum capital requirement of 200 Million (approx. 7 Million USD) to start up a bank were recently extended to the NBDTIs, which all NBDTIs met (BoM 2013). In addition, the NBDTIs are required to maintain a capital adequacy ratio of 10 % as per the *Guideline on Capital Adequacy Ratio for* NBDTIs. However, the NBDTIs are not allowed to offer Islāmic Banking services under the section 6 (a) of the Banking Act 2004.

While the NBDTIs and Money changers are under the purview of the BoM, insurance companies and Non-Banking Financial Institutions (NBFIs) such as Stock Exchange, Insurance, Leasing companies and Global Business Companies are regulated by the Mauritius Financial Services Commission.

Insurance penetration in Mauritius was estimated at 6.0 per cent of GDP in 2012 (FSR 2013). According to FSC (2013), total assets for the life insurance industry increased by 10.0 per cent y-o-y to Rs92.6 billion in 2012, and total net premiums were up by 7.1 per cent to Rs13.5 billion. For the general insurance business sector, total assets and total net premiums increased by 6.4 per cent and 5.7 per cent y-o-y to Rs12.4 billion and Rs3.9 billion, respectively (*ibid*).

The emergence of Mauritius as an international platform for trade and business cannot be denied. The Island combines the advantages of a traditional offshore financial center with the capacity for treaty based tax planning through its network of double taxation avoidance treaties. Mauritius as of today has an active double taxation agreement (DTA) with 39 countries (FSC 2013). Mauritius has also put in place the necessary regulatory framework for setting up international trusts and foundations. It is worth noting that as part of Bank of Mauritius' initiative to turn

Mauritius into a regional financial centre, the Mauritius Automated Clearing and Settlement System (MACSS) was launched in December 2000 (BOM 2001) and the Mauritius Credit Bureau Information (MCIB) became operational in 2005 (BOM 2005). The former initiative indeed enhances the scope for efficient liquidity management by the banks and other participant while the latter maintains the robustness of the credit market and prevents adverse selection problems.

Additional measures were also taken by the Mauritius government to enhance and facilitate a sustainable business environment, which include the establishment of the Competition Commission of Mauritius in 2009 (CCM 2010) and the Mauritius International Arbitration Centre Limited (MIAC) with the collaboration of the London Court of International Arbitration in 2010 (MIAC 2012). However, Mauritius whose regulatory framework has been fully amended to accommodate Islāmic financial services has seen little development in the Islāmic financial services area. This aspect will be further discussed in the next section.

3. Islāmic finance in Mauritius

The history of Islāmic finance in Mauritius dates back to 1871[2] and in modern age to 1992, when the first Sharī'ah compliant fund was introduced in the country. A comprehensive study and analysis of the latter is discussed in Lallmahamood (2013). Prior to the regulatory changes, other initiatives to offer Sharī'ah compliant products included micro-financing by AL BARAKAH Multi-purpose Co-operative Society Limited and the Authorized Long-Term Ethical Equity Fund (ALEEF).

AL BARAKAH Multi-purpose Co-operative Society Limited, formed by some members of the Muslims community was registered on 10th June 1998 under the Co-operative Societies Act 1976/Co-operatives Act 2005. Mamode Raffick Nabee Mohomed, Secretary of the Cooperative says in this regard:

> "As of today, the Cooperative has 2000 + members/shareholders. We have nine regional offices over the island serving our members. We use Islāmic Financing techniques to cater for the financial needs of our members and we provide the following tailor-made schemes: Household General Financing, Computer Financing, Home Financing, Traders

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[2]According to Assoc. Professor Abdool Cader Kalla, a local Mauritius Historian, "Muslims merchant was involved with some whites' settlers who faced economic problems, these merchants entered into a profit sharing partnership basis". This under going study is derived from the case of Abou Baker Mamode Taher (Taherbagh) and Darne of L.'Industrie in 1887.

Financing, Motor Vehicle Financing, Motor Cycle Financing, Air Ticket Financing and Real Estate Financing (Land & buildings) under *murabahah* and *istisna'*. We have also an Interest-Free-Loan (*qard al-hasan*) product where we allocate 5% of the share capital for medical and educational purposes. We have the *hajj* Savings Account to enable prospective hajjes – pilgrims to save regularly to perform *hajj* and participate in Sharī'ah -compliant business activities and earn *halal* returns. This product is open to shareholders of Al Barakah as well as Muslims at large. We have also *mushārakah* agreements with members on certain business activities. We have developed the concept of co-operative insurance- *Takaful Ta'awuni* and established the Cooperative Solidarity/*Takaful* Fund which will be for the debt coverage of debtors of Al Barakah MCSL and also compensate the beneficiaries of shareholders a specified amount/funeral benefit in case of the members' death".

Another initiative undertaken by wealthy Mauritian Muslim professionals and businessmen was the setting-up of an open ended fund as an "Authorized Long-Term Ethical Equity Fund ltd" (ALEEF) in 1999. ALEEF has registered a good performance with a growth of its NAV by 49.7% over a 5-years period. However, in spite of an increase of its NAV, the company paid relatively low yearly dividend (less than 2%) as nearly all of its liquidity / incomes were invested in equities, hence curbing down the level of dividend payments. This is in line with Fund's objective of maximizing long term return through capital growth. However low dividend payments reduced attractiveness of the fund to investors. A critical review of the product shows that the Fund is not under any supervision of a Sharī'ah advisor or Sharī'ah supervisory board.

It was only in 2006 that Islāmic finance received the attention of the Mauritius government. In line with the government's financial plans and policies, the Finance Minister announced several measures in the 2006 budget. The Banking Act 2004 was amended in 2007to include Islāmic Banking business in the banks services. According the Guideline for Conducting Islāmic Banking Businesses issued by the BoM in 2008, all existing licensed banks are deemed to offer Islāmic banking services under the concept of Islāmic Windows. The guideline also sets the requirement of a Sharī'ah advisor or Sharī'ah supervisory board for licensed institutions offering Islāmic banking businesses (Lallmahamood, 2008).

The Mauritius government recognizes that given the nature and structure of Islāmic financial products, they tend to attract more tax than their counterparts. The overall policy approach was to align the tax treatment of Islāmic contracts with the treatment of conventional financing

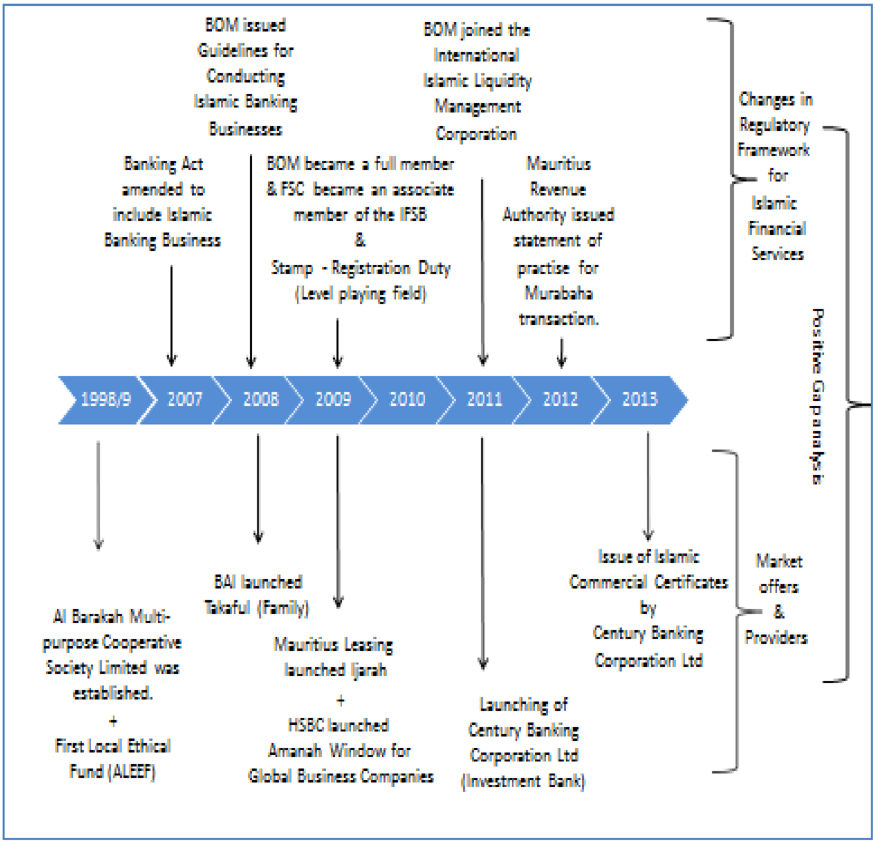
contracts for a level playing field. In line with this policy, the Finance bill 2009 included several changes and waived the imposition of double stamp duties in Islāmic transactions involving real estate and movable property. In the same year, the BoM became a full member of the Islāmic Financial Services Board (IFSB), while the Financial Services Commission opted for the associate membership (FSC 2010). The country is thus the second non-Islāmic country after Singapore to join the IFSB. In 2011, the BoM made another leap to join the International Islāmic Liquidity Management Corporation (IILMC). In the same year, the Mauritius Revenue Authority issued a statement of practice for *murabahah* to avoid double value added taxes (VAT) (MRA 2010).

Meanwhile, new actors, products and services started to emerge in the market. In 2008, the British American Investment launched its Islāmic life Insurance (*Takaful*) and the Mauritius Leasing Ltd offered "*Ijarah*" within its line of products and services in 2009. HSBC Bank (Mauritius) which solely operates as an offshore bank, launched an Islāmic window under the worldwide HSBC *Amanah* brand in May 2009. In 2011, Century Banking Corporation, a joint venture between the British American Investment, a local based company and Domasol, a Malta based company, began its operations as the first Islāmic investment bank in March 2011 (CBC 2013). While the wealth management unit of the domestic Hongkong and Shanghai Banking Corporation Ltd started to distribute Sharī'ah Global Equity Fund in the local market (HSBC 2012), the Islāmic Window HSBC Amanah ceased operation in June 2012 (Weekly 2012).

The performance of the above two products "*takaful*" and "*ijarah*" should provide an indication of how well the market reacted to these concepts. An investigation of these products did not show a positive response; the former product is put on hold for unknown reason, while the latter ceased to be offered after merger with Mauritius Leasing Company Ltd and Bramer Holding Company Ltd (Bramer 2013) in May 2012 on the basis that the all Islāmic products and services offered by a conventional bank should be operated by an Islāmic window.

The latest development in the industry is that Meezan Bank, Pakistan's largest Islāmic bank, has entered into an agreement with Ethical Finance Limited (EFL), a limited liability company set up with the objective of setting up Republic of Mauritius' first retail Islāmic bank (Meezan Bnak, 2013) and that the Bank of Mauritius co-hosted the IRTI-IFSB Summit in May 2014.

Figure 1: Mauritius: Changes in Regulatory Framework versus Market Offers



Source: Author Analysis & Summary

Despite all the efforts to provide Islāmic financial services by the Mauritius Government, the private sector made sporadic development. Mauritius hence has a dual banking system which is governed, regulated and supervised by the Central Bank of Mauritius. Why Islāmic financial services are not taking off at full speed remains the unsolved question for many, and is discussed in the next section.

3.1 Why the slower growth of the Mauritius Market for Islāmic Banking and Finance?

One cannot discuss the prospects and challenges of the Islāmic financial market unless a study of the Muslim community and population is critically reviewed in its respective market. It is often argued that one of the most important market segments for Islāmic banking and finance is constructed on the size of the Muslim population in the Organization of Islāmic Countries (OIC) as well as the fast expanding Muslim population in many developed European cities and the United States. The study of the Muslim population in Mauritius and how they dealt and managed “*rib*┐ ” in the absence of Islāmic banks is already discussed (Muslim in Mauritius: Lallmahamood, 2013).

Today, the Muslim population in the Island represents 17.7%. Almost 17% are of Indian origin of India. Although Muslims may appear to others as a relatively homogeneous and united social group, they are in fact internally divided into sects and schools of thought (*ibid*).

Table 4: A representation of Mauritius Population in 1962, 1972 and 2011

Year	**1962**		**1972**		**2011**	
	Total Number	Percentage	Total Number	Percentage	Total Number	Percentage
Hindu	344,622	49.2%	428,345	50.3%	599,988	50.2%
Muslim	110,404	15.8%	137,171	16.1%	212,303	17.7%
Sino-Mauritian	23,436	3.3%	24,373	2.9%	N/A	
General Population	221,492	31.6%	261,079	30.7%	365,050	30.5%
Total Population	699,954		850,968		1,196,383	

Source: Statistic Mauritius, Housing and Population Census 2011.

While it is claimed that the market segment for Islāmic financial services is divided into 4 categories, Mauritius faces a major challenge to meet the critical mass to launch Islāmic product and services. Table 5 illustrates the four types of segments.

Table 5: Market Segmentation for Islāmic Products

Segment I	Ready market	Will join out of faith
Segment II	Potential Market I	Will join if return is comparable though less rewarding than through the conventional system, deposit rates being slightly lower and investment rates slightly higher than in the conventional market.
Segment III	Potential Market II	Will join if return is better than the conventional market.
Segment IV	Untouchable Market	Do not believe in the system and is not interested to know about the system.

Source: Ernst & Young - The Islāmic fund and investment report 1999

The first three market segments, as indicated above, are considered as niche markets. But, there is little evidence for relying on the above three segments to be instrumental to the success of an Islāmic bank. In the same context, recent studies indicate a deeper need to investigate the importance of marketing Islāmic banking. According to Al-Haran's (1995), Islāmic banking should no longer be regarded as a business entity striving to fulfil the religious obligations but as a viable business that can win over customers (Dusuki & Abdullah 2006).

The business environment among the Muslims as described by Hollup in his study conducted in 1996 is still prevailing. Hollup's (1996) comprehensive discription of the image of the trading community is summarized as;

"Occupations among Muslims include small planters, labourers, textile workers, bus conductors, taxi drivers, artisans, shoemakers, barbers, tailors, goldsmiths, hawkers, vegetable sellers, professionals, and government servants. While Muslims hold many occupations, the many in trade stress the value of becoming economically independent and the advantage of being self-employed. Many got involved in trade due to various political constraints. Some also say that petty trade is an "Islāmic profession" and commercial activity is the best choice for a Muslim; therefore, trade becomes an important self-image and representation".

In an earlier study, Hollup (1992) indicated that Muslims found it increasingly difficult to obtain government jobs and therefore had to look for other options for upward mobility. As in other parts of the world, minorities in Mauritius, predominantly Chinese and Muslims, tend towards trade and business. Although, Muslims have a very positive attitude towards trade and business, the unsolved argument is how sustainable are these businesses in the long term.

It is worth noting that the Mauritius economy has been dominated by two tiers of private companies. The first tier consists of a few large family-owned companies which use holding companies and cross-shareholdings to manage and control their stakes. The second tier of this dual economy is made up of a cluster of family owned small and medium-sized companies. However, over the past 3 decades, a new economic structure has surfaced and seems to be essential to the socio-economic development of a substantial number of people. The development of this informal economy is associated to the pressing demands of local buyers and the economic environment, and they are *"Marchands Ambulant"* (Hawkers & peddlers).

"Marchands Ambulant" that may be considered as a new economic structure appear to be essential to the socio-economic development for a number of families in the Island. The Muslims are the majority of the *"Marchands Ambulant"* according to the City Council of Port Louis (2013) registry. The elusive objective of these *"Marchands Ambulant"* is to provide the basic needs for their families, and improve their socio-economic status. Local government has not been successful in regulating this informal industry, may be because of lack of institutional reforms "whom should development serve" or because lack of economic policies in Mauritius at the bottom of the pyramid. "*Marchands ambulant*" face numerous challenges, among them the fact that mainly private companies and SMEs have access to capital from financial institutions.

Any financial institution which wishes to benefit the society would be required to cater for all the categories or classes of individuals and private companies. Hence on, the business strategy in establishing an Islāmic bank or Islāmic banking, as a viable alternative, has to be through:

- Providing services which would serve niche customers who are looking for this type of service;
- Offering products and services whose pricing is competitive and which satisfy the needs of the market; and

- Allocating a proposed return to depositors which is comparable to if not better than, that which conventional banks are providing;

At the same time, Islāmic banks may face some challenges which are discussed in the next section.

3.2 Challenges Faced to Implement Islāmic Finance

Despite the considerable achievements of Islāmic banks over the last twenty years, Islāmic banks face a number of serious challenges for their viability and growth in the 21st century. The most comprehensive study to describe the major challenges faced by Islāmic financial institutions was conducted by Iqbal, Ahmed & Khan (1998). In this study, the authors divided the challenges into two categories. The first category are the institutional aspects which include proper institutional framework, appropriate legal framework & support policies, supervisory framework, accounting standards, lack of equity institutions, establishment of organized secondary financial markets and need for market for short-term placements of funds. The second category is the operational aspects which deal with financial engineering, some other Sharī'ah issues, teaching, training, research & development, lack of profit-sharing finance, mobilizing of deposits and endogenising placement, competition and globalization.

3.2.1 Challenges that an Islāmic bank may face in Mauritius at its inception are:

a) Liquidity management and interbank deposits

Management of liquidity is important to any business. Liquidity risk for a bank includes both the risk of being unable to fund its financing commitments (on the asset side) and risk of being unable to meet the demand for withdrawals (on deposits / liability side). Due to lack of Islāmic instruments for liquidity management and less developed infrastructure in Mauritius, Islāmic banking faces more difficulties compared with the conventional banks and the Islāmic banking windows of conventional banks. There is, therefore, a significant risk in Islāmic banks, owing to the limited availability of Sharī'ah-compatible money market instrument and lender of last resort.

b) Lack of knowledge and Understanding of Sharī'ah compliant products

A common issue while promoting Islāmic banking and finance in any part of the world is that there is a diversity of opinion as to whether particular practices or products are Sharī'ah-compliant. In the Mauritius context, it is

clear that there is a shortage of appropriately qualified Sharīʻah scholars. This may have significant impact for Islāmic bank to promote its products and services. Local "*Muft┘ s*", Muslim legal experts who are empowered to give rulings on religious matters in the community are not fully up-to-date with all the latest Islāmic financial instruments, while the "*Im┐ m*", a person who leads prayers in a mosque is not conversant with Islāmic products. The latter is the person who interacts more with the Muslim community.

c) Sharīʻah compliant risk mitigation – Exposure to legal risks

While the local regulatory framework caters for Islāmic finance and the enforceability of terms and conditions depends on the governing law, there is no precedent for how a particular case or default will be handled in the court. Therefore, Islāmic bank is exposed to particular legal risks on the basis that the documentation is new and not well-tested in the courts, and this adds to the legal risk.

d) Human resource

It is widely acknowledged that there is a global shortage of experienced professionals in the Islāmic finance sector. There is clear scope for more education and training in the relevant fields in Mauritius. Today, the University of Mauritius does not offer any module or courses on Islāmic banking. In addition, the shortage of resources also extends to Sharīʻah scholars having the relevant banking experience. To address this, Islāmic banking has to play the role in developing more knowledgeable scholars.

e) Increasing competition from existing conventional banks and Islāmic windows

Newly set up Islāmic banks have to face stiff competition in the industry. A conventional bank which has built up a reputation acts as a barrier for entry of Islāmic banks. In addition, Islāmic windows have several advantages over full-fledged Islāmic banks. One common advantage is that Islāmic Window is run on shared services while maintaining only a segregation of accounts, whereas the full-fledged Islāmic bank has a higher operating expense and capital expenditure.

4. Potential for Islāmic Financial Institutions in Mauritius

Mauritius as a strategic global business centre situated in the Indian Ocean region offers investors an efficient vehicle for tax structuring and planning under two categories of Global Business Companies (GBCs) license – GBC-1 and GBC-2, with a flat rate of income tax of 15%. However, companies or funds holding a Category 1 Global Business license are

effectively taxed at a maximum rate of 3% and can end up paying no income tax depending on the foreign tax credit (FSC, 2010), and dividends paid by a Mauritian company are exempt from tax and there is no capital-gains tax in the island other than on sale of immovable assets in Mauritius.

While the above benefits are attractive for international investors, they shall be extended to Islāmic financial services. The offshore sector has fully taken the opportunity to explore these fiscal and non-fiscal incentives. Today, there are only three Sharī'ah global funds domiciled from the local jurisdiction (Bloomberg 2013).

Other opportunities in the sector include the issuance of *"ṣukūk "* (Islāmic alternative to bonds). The island is an ideal location for setting up an SPV as the user in a *"ṣukūk "* transaction. According to Uteem (2010), "a SPV can be setup in Mauritius as a company holding either a category One Global Business License (GBL 1) or a Category two Global Business License (GBL 2) or as a trust. A GBL 2 is a tax-free entity while GBL 1 is a tax resident in Mauritius and can enjoy the full advantages of the double-taxation treaties signed by Mauritius. Provided that its settlor and beneficiaries are non-resident, the trust can either opt to be resident in Mauritius and pay income tax at the rate of 15%, or opt to be treated as non-resident and be exempt from income tax. There will be no withholding tax in Mauritius on the periodic payments or on the reimbursement of capital to the *ṣukūk* holders who are not resident in Mauritius.

If the underlying assets are located in a country with which Mauritius has a double taxation agreement then, depending on the terms of the DTA, there may be no capital-gains tax payable when the Mauritius SPV sells back the assets to the original owner. If the underlying assets are not immovable assets and the Mauritius SPV does not have a permanent establishment in the source country, then the Mauritius SPV may end up not paying any tax in the source country in the rental income derived from the lease of the assets. If the underlying assets are no located in a country with which Mauritius has a DTA, then the SPV can be set up as a GBL 2 or as non-resident trust and be exempt from all income tax".

All SPVs are enforceable in Mauritius. In the case of dispute, the courts in Mauritius can effect to any arbitration clause chosen by the parties and the parties can have recourse to the Privy Council in England which is the ultimate Court of Appeal. A brief of the tax allowances and other exemptions for setting up a special purpose vehicle (SPV) is summarized in table 5.

Table 5: Tax Allowances and other exemptions for Setting up SPV for *Ṣukūk*

Special Purpose Vehicle (Tax Allowances)	Global Business License 1	Global Business License 2
Tax System & Structure	Tax Resident subject to DTA treaties	Tax-Free Entity
Settlor & Beneficiary	Non Resident - Tax Free Resident - Tax rate of 15% is applicable	
Withholding Tax	*ṣukūk* holders: No withholding tax on periodic payment and the reimbursement of capital for non- resident	
Underlying Assets (1) Immovable (2) Movable assets (3) Assets outside DTA treaties	No capital gain tax payable is applied when the assets is sold back to the original owner (subject to DTA agreement). Mauritius SPV – No tax applicable in the source country on rental income derived from the leased assets. Set up SPV as a GBL 2 or as a non-resident trust for exemption from all income tax.	

A recent example of a *ṣukūk* issued from the local jurisdiction is the Islāmic medium note ("*ṣukūk murabahah*") programme of up to Ringgit Malaysia 5 billion based on the Sharīʿah principle of *murabahah* via *tawarruq* arrangement (SC 2012).

In the domestic market, some useful facts and prospects that any Islāmic financial institution will consider are:

a) The total amount of *zakat* collected is MRU 50 Million in 2013 in Mauritius according to IWF (2014). Hence, the total wealth subjected to *zakat* is MRU 2 Billion (MRU 50 Million / 0.025) which excludes investment on fixed assets and immovable properties. The figure excluding non- *zakat*able items represents 0.7% of the total GDP for the year 2012.

b) There are 388 *Waqfs* in Mauritius according to the Board of Waqf Commissioners (2014) and there are a minimum of 2000 *hajj* pilgrims per year according to the Islāmic Cultural Centre (2014).

c) Any commercial Islāmic bank will be considered as first-mover advantage and shall cannibalize the conventional market shares. A simple analysis shows that 1% of the total conventional deposits amounts MRU 2.7 Billion (Table 6). Any first Islāmic commercial bank can meet a target of total cumulative deposits of MRU 1.3 billion for the first three years (400 Million, 450 Million and 500 Million respectively) which represents half of the 2.74 Billion.

Table 6: Abstract of Consolidated Statement of Liabilities and Assets of Banks - Segmental Reporting: As at end of September 2013

Liabilities	Segment A (MRU)	Segment B (MRU)	Total (MRU)
Deposits (Residents Only)	272,249,192,533	1,328,852,048	273,578,044,581

d) There are prospects for regional expansion. These are mainly based on the following:

i. There are currently no Islāmic banks in the neighbouring island countries Reunion, Madagascar and Comores.

ii. The Muslim population of these countries contributes a significant amount to the gross domestic products.

iii. All banks in Mauritius have the option to communicate in a preferred language. Hence, language is not considered a barrier.

iv. There is no foreign exchange control in Mauritius; therefore there is no restriction for a non-resident to open an account with the local banks according to Banks' policies.

v. Muslim businessmen from the neighboring countries use Mauritius International Airport as a gateway to other destinations, such as Singapore, India, Dubai, South Africa and Australia.

e) Mauritius is ranked the no.1 in Africa for ease of access to banks though financial systems in Africa generally lag behind those in other developing economies. According to the Financial Inclusion in Africa Report (2012), 80% of adults and 97% of SMEs in Mauritius have an account at any formal financial institution in Mauritius.

For any Islāmic financial institution to succeed in Mauritius, it must have a solid business strategy and value proposition which includes key offerings under the consumer banking, commercial banking, corporate banking, investment banking and treasury. While the basic key business principles such as robust risk management, building capability and business innovation should be part of the business strategy & plan, a lean management and leadership are the critical factors for the set up and implementation of Islāmic banks in Mauritius.

5. Conclusion

Mauritius, being strategically located in the Indian Ocean has built a solid reputation as a premier international business hub, providing operational

security and commercial flexibility to investors over the past two decades. Mauritius has joined other non-Muslim states to include Islāmic financial services by revising its regulatory framework and tax structure. Yet, despite all the efforts to promote Islāmic financial services by the Mauritius Government, the private sector has made only sporadic development.

Islāmic initiatives in the Island are mainly driven by potential investors in the offshore sector, which is an ideal platform to set up global Sharī'ah fund and the issuance of "*ṣukūk"*. In the domestic market, a handful of Islāmic products, such as Microfinance, ALEEF FUND, *takaful*, *ijarah* and Global Sharī'ah Equity Fund, have been introduced. Responses to the above products have been marginal and insignificant.

While this paper has attempted to show some critical success factors to establish full-fledged Islāmic banks in Mauritius, there is no doubt that challenges remain to be ment. A big challenge for any Islāmic bank at the inception is the availability of the critical mass of the market. Other major challenges include liquidity management, increasing competition from existing conventional banks and the absence of a comprehensive awareness programme.

While further empirical research is required to understand and deepen the understanding of the market, only a full-fledged operational Islāmic bank or Islāmic Windows in the domestic market will provide an appraisal of the success factors. The success and future of the Islāmic finance and banking depend on how the major players such as the existing financial institutions and the private sector position their products and services.

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Appendix–1

Mauritian Laws applicable to relevant sectors

1. **Laws applicable to all sectors:**

   Company and Business Laws
   Companies Act 2001 - Business Facilitation Act - Local Government Act - Code Civil Mauricien - Code de Commerce
   Code de Procédure Civile - The Investment Promotion Act
   Taxation Laws
   Income Tax Act- Value Added Tax Act - Customs Tax Act - Customs Tariff Act - Excise Act - Double Taxation Agreements
   Criminal Laws
   Criminal Code Act - Financial Intelligence and Anti-Money Laundering Act - Prevention of Corruption Act - The Economic Crime and Anti-Money Laundering Act - Non-Citizens Property Restriction Act
   Property Laws
   Land Acquisition Act - Landlord and Tenant Act - Land Duties and Taxes Act - State Lands Act
   Trade and Consumer Protection Laws
   Competition Act - Fair Trading Act - Legal Metrology Act - Consumer Protection Act - Public Health Act
   Employment Laws
   Employment Rights Act - Employment Relations Act - Occupational Safety, Health and Welfare Act - Remuneration Orders
   Non-Citizens Employment Restriction Act - Additional Remuneration Act - End of Year Gratuity Act - Sex Discrimination Act
   Environmental Laws
   The Environment Protection Act - Dangerous Chemicals Act - Forests and Reserves Act
   Intellectual Property Laws
   Copyright Act - The Patents, Industrial Designs and Trademarks Act - The Protection Against Unfair Practices (Industrial Property Rights) Act
   Communications and Media Law
   Data Protection Act - Electronic Transaction Act- ICT Act -Postal Services Act - Computer Misuse and Cybercrime Act

2. **Main Laws by Sector**
   Commerce and Manufacturing
   Food Commodities: Food Act - Jewelry: Jewelry Act - Handicrafts and SMEs: Small Enterprises and Handicraft Development Act - Textile and Garments: Fashion and Design Act
   Tourism
   The Tourism Act - Tourism Authority Act - The Tourism Employees Welfare Fund Act - The Travel Agents and Tour Operators Act 2001 -

Regulation for Tourist Act 2002 (Issue of Licence) - Regulation for Tour Operators (Issue of Licence) - Regulation for Travel Agents (Issue of Licence) - Regulation for Travel Agents and Tour Operators (Security)

Information and Communication Technology

Data Protection Act - Electronic Transaction Act - ICT Act -Postal Services Act

Computer Misuse and Cybercrime Act

Financial Services Sector

The Financial Services Act 2007 - The Protected Cell Companies Act 1999 - The Trust Act 2001 - The Securities Act 2005 - The Stock Exchange Act - The Unit Trust Act - The Financial Intelligence and Anti-Money Laundering Act - Insurance Act -The Approved Investment Institution Rules 1992

3. Laws of General Application

Constitutional law - Constitution of Mauritius,

Human Rights - Protection of Human Rights Act 1998

Litigation and court procedure

Courts Act - Code de Procédure Civile

Administrative / Public Law

Civil Status Act - Deportation Act - Immigration Act - Mauritius Citizenship Act - Passport Act - Public Procurement Act 2006 (Act No. 33 Of 2006) - The Ombudsman Act - Certificate Of Morality Act 2006 (Act No. 22 Of 2006)

Appendix-2: List of Banks in Mauritius

List of Banks in Mauritius	Local bank	Foreign owned Subsidiary	Branch of foreign banks	Joint Venture Bank	Net Profit for Financial year MUR 000	Total liabilities, equity and reserves as at June 2013 MUR 000 (1 USD = 30 MUR) (1 GDP = 50 MUR)
ABC Banking Corporation	√				2,223	7,309,694
AfrAsia Bank Limited	√				302,596	31,459.700
Bank of Baroda (as at 31 March 2013)			√		171,766	33,042,267
Bank One Limited (Dec 2012)				√	203,368	19,403,582
Banque des Mascareignes Ltée (Dec 2012)		√			(692,610)	21,115,895
BanyanTree Bank Limited		√			-	-

Barclays Bank Mauritius Ltd (31 Dec 2012)		√			1,018,000	93,281,000
Bramer Banking Corporation (31 Dec 2012)	√				16,542	10,878,488
Century Banking Corporation (31 Dec 2012)		√			(40,494)	270,441
Deutsche Bank (Mauritius) Limited (31 Dec 2012)		√			86,402	34,129,400
Habib Bank Ltd (31 Dec 2012)			√		14,587	1,693,670
HSBC Bank (Mauritius) Limited (31 Dec 2012)		√			1,994,970	133,395,810
Investec Bank (Mauritius) Limited (31 March 2013)		√			989,820	41,147,940
Mauritius Post & Cooperative Bank Ltd (31 Dec 2012)	√				128,018	14,963,736
P.T Bank Internasional Indonesia (31 Dec 2012)			√		23,585	1,117,585
State Bank of India (Mauritius) Ltd (31 March 2013)		√			286,542	36,544,813
Standard Bank (Mauritius) Limited (31 Dec 2012)		√			(375,811)	68,234,356
Standard Chartered Bank (Mauritius) Ltd (31 Dec 2012)		√			944,880	102,798,000
State Bank of Mauritius Ltd (30 June 2012)	√				4,014,143	93,723,276
The Hong Kong and Shanghai Banking Corporation Limited (31 Dec 2012)			√		349,491	26,986,804
The Mauritius Commercial Bank Ltd	√				4,349,668	216,563,388

Appendix 3: CAMEL Ratings

Bank of Mauritius

website: https://www.bom.mu

COMMUNIQUÉ

CAMEL Rating for Banks – June 2013

The Bank of Mauritius, in consultation with banks, has today disclosed the composite CAMEL rating for individual banks for the quarter ended June 2013.[1] The ratings constitute an expression of opinion of the Bank of Mauritius, as regulator, on the financial condition of a bank at a particular point in time and should not be construed as an assessment that will not change in future.

The CAMEL ratings are published on a bi-annual basis, in June and December of each year. The ratings for the quarter ending 31 December 2013 will be published in June 2014.

CAMEL Ratings for the Quarter ended 30 June 2013

Bank	Overall Rating *
ABC Banking Corporation Ltd	3+
AfrAsia Bank Limited	2+
Bank of Baroda	2+
Bank One Limited	3+
Banque des Mascareignes Ltée	3+
BanyanTree Bank Limited	3+
Barclays Bank PLC	2-
Bramer Banking Corporation Ltd	3-
Century Banking Corporation Ltd	4
Deutsche Bank (Mauritius) Limited	2+
Habib Bank Limited	2+
HSBC Bank (Mauritius) Limited	2+
Investec Bank (Mauritius) Limited	2+
Mauritius Post and Cooperative Bank Ltd	3+
P.T Bank Internasional Indonesia	2+
SBI (Mauritius) Ltd	2-
Standard Bank (Mauritius) Limited	2-
Standard Chartered Bank (Mauritius) Limited	2-
State Bank of Mauritius Ltd	2+
The Hongkong and Shanghai Banking Corporation Limited	2+
The Mauritius Commercial Bank Limited	2+

**** 1: Strong 2+ and 2- : Satisfactory 3+ and 3- : Fair 4 : Marginal 5 : Unsatisfactory***

[1] *The CAMEL Rating is an international bank-rating system with which bank supervisory authorities rate institutions according to the following factors that cover financial, operational and managerial performance, represented by the acronym "CAMEL":*

C - Capital adequacy
A - Asset quality
M - Management
E - Earnings
L - Liquidity

The ratings published refer to the overall rating of a bank – i.e., the score ranging between 1 and 5 based on a weighted numerical computation using each of the five core components.

27 December 2013